DOD, OSD
76-067
BOX 73
Iran 1970

INTERNATIONAL SECURITY AFFAIRS

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D. C. 20301

9 MAY 1970

In reply refer to:
I-22187/70

[redacted]

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: Iran Foreign Military Sales Credit

Following is the information you requested on Iran FMS credit:

1. From FY 65 through FY 69, Iran received $500 million in credit to purchase military equipment. Iran's principal and interest repayments during FY 70 will amount to approximately $38.0 million, of which $18.7 million is due between 30 April - 30 June 1970. Iran has never defaulted on its repayment obligations.

2. You may recall that there have been two letters exchanged between the President and the Shah concerning FMS credit for Iran. The President in his 16 April 1970 letter told the Shah that the US will "make every effort to reach a satisfactory agreement with your representatives. We will be as forthcoming as is possible in meeting your concerns about the terms of the FY 70 credit." Following the delivery of this letter to the Shah, Under Secretary Richardson, in his audience with the Shah on 20 April 1970, expressed his "earnest desire to do everything...within Congressional limitations" to help Iran in future credit years (specifically, FY 1974-77). Accordingly, Mr. Richardson promised that the USG is ready to examine with the Shah his military requirements "with a view to extending the 1968 agreement to provide for acquisition of equipment not presently envisioned under that agreement." This agreement by Mr. Richardson was coordinated with the Department of Defense, and after lengthy negotiations between State and Defense, this version of the statement was finally achieved. Mr. Richardson also expressed to the Iranian Prime Minister his belief that there is a need for a careful task force study of Iran's future defense needs, and to this end Chief ARMISH MAAG and the head of the Iranian defense industries will be meeting in preliminary discussions.

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3. Status of the Iranian FY 70 credit program is as follows:

a. On 17 March 1970 the NSCIG/NEA decided, and the White House has been informed, that the mix of Government and private interest rates on this credit should result in an overall rate of not less than the cost of money to the US Treasury at the time the credit is negotiated. There was also a consensus that the overall interest rate should not exceed substantially the cost of money to the US Treasury.

Sec Def Cont Nr. X-2546

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b. During hearings before the HFAC on the FMS Act on 5 February and 17 February, and on 11 March before Chairman Passman's Appropriations Committee, you, as well as Mr. Packard and General Warren, in response to specific questions relating to the rate of interest charged on credit funds (NOA) being requested from the Congress, replied that we will charge interest rates equal to the prevailing cost of money to the Government. Although Mr. Packard noted to the HFAC that we could grant "special interest rates," he went on to say "we have adhered rather strictly to the policy of requiring interest on these credit sales at the current cost of money." In a response to Fulbright Committee questions on rates of interest for FY 70, we provided a table listing the credit terms which showed that interest rates for all countries would be at the current cost of money to the US Treasury (prevailing rate is 7-1/8%).

c. We believe that all three Committee Chairmen, i.e., Morgan, Fulbright and Passman, are convinced that we will not grant concessionary terms on FY 70 and 71 Government-appropriated FMS credit funds. Chairman Passman is particularly sensitive on the subject of concessionary rates and in reply to your statement that we charge the prevailing cost of money to the US Government stated, "I want to commend you for your program of short terms and the interest rate that you are charging the countries that borrow."

d. Section 34 of the FMS Act empowers the President to establish "standards and criteria for credit and guaranty transactions...in accordance with the foreign, national security and financial policies of the United States." The present standards and criteria established in February 1969, and reviewed by the National Security Council, apply to the FY 70 credit program. These provide that for those transactions in which direct Defense Department credit is combined with private credit, the interest rate on the Defense credit will be such that the rate for the combined package is not less than the cost of money to the US Government. To implement this policy, Treasury has determined that a combination private/public credit could include the US Government portion at not less than 6% interest to balance off the higher private interest rate, provided that the effective or combination rate is not lower than the current cost of money to the US Treasury. This is not concessionary credit, but if the effective rate is less than cost of money, or if the US Government portion is less than 6%, this would constitute "concessionary" credit. We believe that the Congress does not fully understand this definition of concessionary credit.

e. We are presently coordinating an updated "Financial Standards and Criteria for Foreign Military Sales" which will be more explicit and clarify our authority to provide for a lower interest rate on the public portion of a mixed public/private credit agreement. The Financial Standards and Criteria also provide that if there are overriding US national interests, concessionary credit, as defined above, may be used.

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f. If we are to achieve the $350 million FY 70 credit program, we must utilize $100 million of private financing. Since we have told Iran that we would undertake to provide $100 million in FMS credit for FY 70, and since this is such a significant proportion of the total FY 70 program, private participation in the Iranian program is essential. The specific mix of Government/private financing and interest rates on each portion is subject to final negotiation. Preliminary discussions with private banks on the basis of a 50/50 or 75/25 mix for Iran indicate that the private rate will be between 8-1/2 - 8-3/4%. Assuming a 50/50 mix, and in order to achieve a net rate at the prevailing 7-1/8% cost of money, the rate on the Government portion would have to be approximately 6-3/8%. Over the 10-year loan period this means that, to quote Chairman Passman, "the US Government would be subsidizing" Iran for approximately $2.0 million. If the same policy is followed for the proposed $100 million FY 71 Iranian program, and assuming that the prevailing rate of interest remains approximately the same, the Congress will probably claim that we also will be subsidizing Iran at the same rate in FY 71. Chairman Passman would view such "concessionary rates" as a "$4 million giveaway program" and would violently oppose it.

4. It is doubtful that we will obtain final legislation on the FY 70 program before mid-June which will leave little time to consummate approximately $280 million in agreements with fifteen countries. We therefore intend to seek State approval for the DOD to proceed with preliminary discussions with selected countries and private banks in order to reach maximum possible agreement prior to passage of the FMS Act. Subject to State agreement, it is also intended that State, assisted by DOD and Treasury, will notify selected members of Congress of the terms of the final credit agreements in those instances where the interest on the public funds is less than the cost of money to the US Treasury. At the same time, the provisions of the Financial Standards and Criteria will be explained in detail. This will be done only after passage of the FY 70 FMS Act.

G. Warren Nutter

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